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Seller's Recovery of Lost Profits for Breach of a Sales Contract: Uniform Commercial Code Section 2-708(2)

SELLER'S RECOVERY OF LOST PROFITS FOR BREACH OF A SALES CONTRACT: UNIFORM COMMERCIAL CODE SECTION 2-708(2)

Uniform Commercial Code section 2-708(2) was enacted to furnish a vehicle for sellers to recover lost profits. Although the section is poorly drafted, judicial interpretation has spawned a sound body of caselaw providing sellers with a firm basis upon which to recover lost profits. This Note discusses the Code section and judicial interpretations and concludes that in many situations 2-708(2) is the only remedy that will make a seller whole after a contract has been breached.

I. INTRODUCTION

The goal of virtually every seller of goods is to earn a reward for his efforts in the form of profits. Therefore, to be made whole after a sales contract is breached by a buyer, the seller's damage recovery must include the profit he expected to earn on the sale.[1]

Many practitioners are not aware of the availability of lost profit recovery under U.C.C. section 2-708(2), a section "enacted in such a gnarled mutation that it . . . barely accomodates some of the cases for which it was originally designed."[2] This Note discusses the different ele-

1. The aim of courts in awarding damages for breach of contract is to place the aggrieved party, as nearly as possible, in the same position as complete performance would have done. *See, e.g.,* Willhelm Lubrication Co. v. Brattrud, 197 Minn. 626, 632, 268 N.W. 634, 637 (1936); Silberstein v. Duluth News Tribune Co., 68 Minn. 430, 432, 71 N.W. 622, 633 (1897); 2 T. SEDGWICK, MEASURE OF DAMAGES § 602 (8th ed. 1891); RESTATEMENT OF CONTRACTS § 329 comment (a) (1932).

There are two frequently discussed purposes of contract damages. One is to prevent breaches. A. CORBIN, CONTRACTS § 1002 (rev. ed. 1964). The second is to provide relief to promisees to redress breaches, thereby protecting the promisee's expectations and encouraging the formation of contracts. Farnsworth, *Legal Remedies for Breach of Contract,* 70 COLUM. L. REV. 1145, 1147 (1970); Speidel & Clay, *Seller's Recovery of Overhead Under U.C.C. Section 2-708(2): Economic Cost Theory and Contract Remedial Policy,* 57 CORNELL L. REV. 681, 684 (1972).

2. J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COM-

ments used to calculate a seller's damages under 2-708(2). It then examines the three general types of sellers eligible for lost profit recovery under the Uniform Commercial Code. The Note concludes that lost profit damages is an important, though underused, remedy available to many deserving sellers.

II. LOST PROFIT RECOVERY BEFORE THE U.C.C.

Historically, aggrieved sellers were awarded damages which guaranteed them the same value for the contract goods as they would have received from the buyer's full performance. The primary remedy was to award the difference between the contract price and the market price of the goods (contract-market damages).[3] Another closely related and often used remedy was to award the difference between the contract price and the price which the seller received from reselling the goods (contract-resale damages).[4] Under these two remedies, if the market or resale value of the goods was less than the contract price, the buyer was required to make up the difference. Finally, in some circumstances, a seller was awarded the full contract price.[5] These three remedies assume that if the seller receives the full contract value of the goods, he will receive precisely what he would have received from full performance of the contract, including his profit.

Certain sellers, however, are not placed in the same position as full performance by receiving the contract value of the goods.[6] The lost vol-

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MERCIAL CODE § 7-13, at 288 (2d ed. 1980). Since the Uniform Commercial Code was first enacted in Pennsylvania in 1953, all United States jurisdictions except Louisiana have adopted some form of it. For an extensive discussion of the Uniform Commercial Code's legislative history, see Braucher, *The Legislative History of the Uniform Commercial Code,* 58 COLUM. L. REV. 798 (1958).

Uniform Commercial Code citations in this Note are to the 1978 official text. Minnesota's Uniform Commercial Code is codified at MINN. STAT. ch. 336 (1982).

3. For example, according to the Uniform Sales Act, MINN. STAT. ch. 512, *repealed by* Uniform Commercial Code, ch. 811, 1965 Minn. Laws 1290, 1484 (codified at MINN. STAT. ch. 336 (1982 & Supp. 1983)) in an action for damages for nonacceptance of goods, where there is an available market for the goods in question and no special circumstances showing proximate damage of a greater amount, the measure of damages is "the difference between the contract price and the contract or current price at the time or times when the goods ought to have been accepted, or, if no time was fixed for acceptance, then at the time of refusal to accept." *Id.* § 512.64(3).

4. *See, e.g.,* Uniform Sales Act, MINN. STAT. ch. 512 (repealed 1965). In the Uniform Commercial Code, the contract-resale measure of damages is set forth in section 2-706.

5. Under the Uniform Sales Act a seller could bring an action for the contract price under three circumstances: (1) when the property in the goods passed to the buyer and the buyer wrongfully neglected or refused to pay for them; (2) when the price was payable on a certain day and the buyer wrongfully neglected or refused to pay; or (3) when the buyer refused to accept completed goods which could not be reasonably resold. MINN. STAT. § 512.63 (repealed 1965).

6. The lost volume seller, *see infra* notes 114-45 and accompanying text, the components seller, *see infra* notes 75-113 and accompanying text, and the jobber seller, *see infra*

ume seller is one.[7] The lost volume seller has enough goods to supply as many buyers as he can find. When one buyer breaches and the contract goods are resold, the lost volume seller loses the profit he expected to make on the sale to the breaching buyer.[8] The profit lost on the breached contract cannot be recovered if the buyer is required to pay only the difference between the contract price and the resale or market price of the goods.[9] Without recovery of the profit, the lost volume seller is not placed in the same position as full performance of the contract would have placed him.

The three traditional remedy formulas[10] are also inadequate when applied to sellers not in possession of finished goods after the breach. Such sellers fall into two groups: components sellers[11] in the midst of production at the time of the breach and jobber sellers[12] who have not acquired

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notes 146-61 and accompanying text, require recovery of lost profits to be put in the same position as full performance.

The earliest recognized type of seller who was inadequately compensated by the three standard remedies was the automobile dealer who resold an automobile which was the subject of the breached contract. The negligible difference between the contract price and the car's resale or market value meant that the dealer was left with no recovery under conventional remedies. To avoid the contract-market damage measure mandated by Uniform Sales Act § 64(3), *see supra* note 3, and award lost profits, courts found "special circumstances" involved in the sale of automobiles. Courts held that each automobile sale necessitated the expenditure of considerable time, effort, and service which would go entirely uncompensated under the contract-market standard. *See* Torkomian v. Russell, 90 Conn. 481, 97 A. 760 (1916); Stewart v. Hansen, 62 Utah 281, 218 P. 959 (1923) (seller lost compensation for time and effort of attempting to sell the car and received nothing for rent, advertising, and other overhead expenses). *But see* A. Lenobel, Inc. v. Senif, 252 A.D. 533, 300 N.Y.S. 226 (1937) (lost profit damages denied to dealer who resold automobile at same price as contract price).

The lost volume characteristics of automobile dealers were also recognized as a basis of lost profit awards. *See* Note, *Sales—Seller's Remedies—Refusal of the Buyer to Accept the Goods—Seller's Measure of Damages,* 21 MINN. L. REV. 716, 726-28 (1937).

7. *See infra* notes 114-45 and accompanying text.

8. The sales volume of a seller without enough goods to supply every buyer is limited by the number of goods he can produce or acquire. A breach allows this seller to resell the contract goods to a buyer whom, but for the breach, he would not have been able to supply. Therefore, the seller's sales volume and potential profit are unaffected by the breach.

The lost volume seller, however, can sell goods to as many buyers as he can find. When one buyer breaches, the lost volume seller resells to a buyer whom he would have been able to supply even if the breach had not occurred. The breach, therefore, reduces his sales volume and his potential profit. *See infra* notes 114-15 and accompanying text.

9. The difference between the contract price of the goods and their resale or market price bears no relationship to the profit the lost seller would have made on the breached contract.

10. *See supra* notes 3-5 and accompanying text.

11. A components seller assembles or manufactures goods for a buyer. *See infra* notes 75-113 and accompanying text.

12. A jobber seller buys goods from a manufacturer or another wholesaler and sells them at a higher price. *See infra* note 146 and accompanying text.

the contract goods at the time of the breach. When the seller has no finished goods on hand, resale is not possible, and any relationship between the seller's damages and the contract price-market price differential is purely coincidental.[13] Moreover, the absence of finished goods precludes the recovery of the contract price.[14] A different remedy must be applied to properly compensate these sellers.

The failure of the three standard remedy formulas to adequately compensate some sellers led to the adoption of a fourth measure of damages: the profits the aggrieved seller would have received from the buyer's full performance.[15] Historically, however, courts disfavored lost profit recovery due to its speculative and conjectural nature.[16] Because profits are

13. The contract-market formula assumes that the seller can recover the market value of the goods through resale. If the seller has no goods to place on the market, the contract-market price differential bears no relationship to the seller's actual loss.

14. Under the Uniform Sales Act, if a seller did not complete or acquire the contract goods, he could only bring an action for price if the contract price was payable irrespective of delivery of the goods. *See, e.g.,* Sherman Nursery Co. v. Aughenbaugh, 93 Minn. 201, 100 N.W. 1101 (1904) ("except where the purchase price of goods is payable irrespective of their delivery, if the buyer repudiates the sale while it is executory, and prevents the seller from performing on his part by making delivery of the goods, the seller cannot maintain an action on the contract for the purchase price"); McCormick Harvesting Mach. Co. v. Balfany, 78 Minn. 370, 81 N.W. 10 (1899) ("before a seller can maintain an action for the agreed price of a chattel, there must be such a delivery, actual or constructive, as will pass the title, and vest the ownership of the property to the purchaser"). Under the U.C.C., a seller may recover the price: (1) when goods have been accepted by the buyer; (2) when conforming goods have been lost or damaged after the risk of loss has passed to the buyer; or (3) when goods have been identified to the contract and the seller is unable to resell them. U.C.C. § 2-709. If the seller does not complete manufacture of the goods or does not acquire them, the goods can never be identified to the contract nor be accepted or conforming. *See* Detroit Power Screwdriver Co. v. Ladney, 25 Mich. App. 478, 181 N.W.2d 828 (1970) (2-709 not applicable where the machine under contract was never completed but stored in a partially finished state); J. WHITE AND R. SUMMERS, *supra* note 2, § 7-5.

15. *See, e.g., Willhelm Lubrication Co.,* 197 Minn. 626, 268 N.W. 634 (damages are properly measured by the difference between the contract price and the entire cost of the goods to the seller in order to include the profit to which the seller is entitled); Green v. Lovejoy, 155 Minn. 241, 193 N.W. 173 (1923) (measure of damages for timber not manufactured is the difference between the contract price and the cost to the seller of manufacturing and delivering the lumber); Baessetti v. Schenango Furnace Co., 122 Minn. 335, 142 N.W. 322 (1913) (where goods are to be manufactured to fill a contract and the buyer renounces the contract before manufacture is complete, the measure of damages is the difference between the contract price and the seller's cost of completing the contract); Masterton v. Mayor of Brooklyn, 7 Hill 61 (N.Y. 1845). For a discussion of *Masterton,* see *infra* notes 19-23 and accompanying text.

16. R. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS § 1.1 (2d ed. 1978); W. HALE & R. COOLEY, HANDBOOK ON THE LAW OF DAMAGES § 32 (2d ed. 1912); 1 T. SEDGWICK, MEASURE OF DAMAGES § 175 (9th ed. 1912). *But see Masterton,* 7 Hill 61.

The defendant in *Masterton* argued that a claim for damage based on the gains the plaintiffs would have received from full performance exceeded the measure of damages allowed at common law for breach of an executory contract. Such a claim, the defendants insisted, "is simply a claim for the profits anticipated from a supposed good bargain and

contingent on market prices of materials, operating efficiency, and other uncertainties, courts were reluctant to award lost profit damages.[17]

Courts made an exception to the general rule against lost profit recovery when the aggrieved party could prove the lost profits with reasonable certainty.[18] In *Masterton v. Mayor of Brooklyn,*[19] an 1845 New York case considered the leading American case on the subject of lost profit damages,[20] the defendant argued that lost profits were too remote and speculative to be recoverable.[21] The court disagreed and awarded the aggrieved seller the difference between the contract price and the seller's cost of fulfilling the contract.[22] The court held that no speculation was necessary because the cost of production could be established by using the market price of the elements of the seller's performance at the time of the breach.[23]

Minnesota courts also recognized the need for a lost profit remedy. In 1926, the Minnesota Supreme Court in *Willhelm Lubrication Co. v. Brattrud*[24] awarded lost profits[25] because they were the only way to place the

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. . . [is] too uncertain, speculative and remote to form the basis of a recovery." *Id.* at 66. The court disagreed and awarded the difference between the contract price and the cost of production. *Id.* at 73.

17. *Cf.* Ludwigsen v. Larsen, 227 Mich. 528, 198 N.W. 900 (1924). The *Ludwigsen* court stated, however, that if the parties contemplated profits, in certain circumstances the jury should be permitted to *consider* them with the other proof in determining just compensation. *Id.* at 531, 198 N.W. at 901.

18. *See, e.g., Willhelm Lubrication Co.,* 197 Minn. 626, 268 N.W. 634; *Lovejoy,* 155 Minn. 241, 193 N.W. 173.

19. 7 Hill 61 (N.Y. 1845).

20. *See* United States v. Speed, 75 U.S. 77, 85 (1868); M & R Contractors & Builders v. Michael, 215 Md. 340, 139 A.2d 350 (1958).

21. 7 Hill at 67.

22. *Id.* at 71.

23. *Id.* In deciding that lost profits are a proper measure of damages in certain circumstances, the court stated:

> [P]rofits or advantages which are the direct and immediate fruits of the contract entered into between the parties . . . are part and parcel of the contract itself, entering into and constituting a portion of its very elements; something stipulated for, the right to enjoyment of which is just as clear and plain as to the fullfillment [sic] of any other stipulation. They are presumed to have been taken into consideration and deliberated upon before the contract was made, and formed perhaps the only inducement to the arrangement. . . . [I]t is difficult to comprehend why, in case one party has deprived the other of the gains or profits of the contract by refusing to perform it, this loss should not constitute a proper item in estimating damages.

Id. at 69.

24. 197 Minn. 626, 268 N.W. 634 (1926).

25. The *Willhelm Lubrication Co.* court calculated lost profits according to the standard set forth in the *Restatement of Contracts.* The *Restatement* states that the difference between the value of the promised performance and the cost of the plaintiff's own performance, if the latter is the lesser sum, "is a profit to which the plaintiff practically always has a right as part of the damages." 197 Minn. at 633, 268 N.W. at 637 (quoting RESTATEMENT OF CONTRACTS § 329 comment (b) (1932)).

seller in the same position as full performance would have done.[26] Unlike courts awarding lost profits under the Uniform Sales Act, the *Wilhelm Lubrication Co.* court did not base its rejection of the contract-market remedy on the narrow grounds of special circumstances or the absence of an available market.[27] The broad grounds used by the Minnesota Supreme Court indicate the court's intention to award lost profits whenever necessary to justly compensate an injured seller.[28] This intention is also the basis for recovery of lost profits under 2-708(2).[29]

III. Recovery Under Section 2-708(2)

Article 2 of the U.C.C. provides four different remedies for an aggrieved seller of goods. Section 2-706 allows a seller to recover the difference between the contract price of the goods and their resale price (contract-resale damages).[30] Section 2-708(1) provides that the seller may recover the difference between the contract price and the market price at the time and place of tender (contract-market damages).[31] The seller may recover the full contract price under 2-709.[32] Finally, under 2-

26. 197 Minn. at 633, 268 N.W. at 637. The court stated:

> Usually the measure is the difference between the contract price and the market price if that measure will fulfill the desideratum, or, if not, the difference between the contract price and the cost of the goods to the seller. Which of the measures or methods to employ in a particular case depends upon which accomplishes the desired purpose.

Id. (citations omitted).

27. *Id.* Under section 64 of the Uniform Sales Act, where there was an available market and no special circumstances, the seller in an action for non-acceptance of goods recovered the difference between the contract price and the market price of the goods. The Minnesota Supreme Court awarded lost profits based on the existing market for the goods in *Lovejoy*, 155 Minn. 241, 193 N.W. 173, and *Baessetti*, 122 Minn. 335, 142 N.W. 322.

28. Note, *supra* note 6, at 729.

29. U.C.C. § 2-708(2) provides:

> If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

Id.

30. U.C.C. § 2-706(1) provides that where "the resale [of the contract goods] is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price . . . ." *Id.*

31. U.C.C. § 2-708(1) provides that "the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price . . . ." *Id.*

32. U.C.C. § 2-709 provides that the seller may recover the price:

> (a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and
> (b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

708(2) the seller may recover the profit he would have made from performance (lost profit damages).[33]

In Minnesota there are three prerequisites to recovering lost profits under 2-708(2).[34] The seller must prove (1) the amount of damages with reasonable certainty;[35] (2) that the buyer's wrongful acts caused the loss of profits; and (3) that the profits were reasonably within the contemplation of the parties when the contract was entered into.[36] "Once the fact of loss has been shown, the difficulty in proving its amount will not preclude recovery so long as there is proof of a reasonable basis upon which to approximate the amount."[37] Courts traditionally consider approximate losses based on average costs or other rough estimates sufficient to establish a prima facie case for lost profits.[38] Because the difficulty of proof is due to the buyer's breach, the U.C.C. requires only that lost profits be proven to the degree of certainty which the facts permit.[39]

A. Liberal Administration of Remedies

The general remedy theory of the U.C.C. is that remedies "shall be

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Id.

33. For the full text of U.C.C. § 2-708(2), see *supra* note 29.

34. MINN. STAT. § 336.2-708(2) (verbatim adoption of U.C.C. § 2-708(2)).

35. Cardinal Consulting Co. v. Circo Resorts, Inc., 297 N.W.2d 260, 267-68 (Minn. 1980) (lost profit damages of an unestablished business are recoverable upon proof with reasonable certainty); *see also* DUNN, *supra* note 16, § 4.2.

In Unique Sys., Inc. v. Zotos Int'l, Inc., 622 F.2d 378 (8th Cir. 1980), the court stated that the burden of proving "lost profits is particularly heavy in the case of a new business." *Id.* at 378. The general rule in Minnesota is that the lost profits of a new business are too speculative to be a basis for recovery. *Id.* (quoting Village of Elbow Lake v. Ottertail Power Co., 281 Minn. 43, 46, 160 N.W.2d 571, 574 (1968)). If there is a reasonable basis upon which to determine the amount of lost profits, however, it is clear that a new business can recover lost profits under Minnesota law. *Id.; see also* Leoni v. Bemis Co., 255 N.W.2d 824, 826 (Minn. 1977).

36. *Unique Sys., Inc.,* 622 F.2d at 378. Although Minnesota requires the seller to prove that the profits lost were within the party's contemplation, it is appropriate in a commercial transaction to assume that the nature of the transaction puts the breaching party on notice that lost profit damages may be suffered. DUNN, *supra* note 16, § 1.10.

In *Unique Sys., Inc.,* the court, applying Minnesota law, awarded lost profits because the absence of a market price for the goods precluded application of the contract-market remedy. 622 F.2d at 378. For a discussion of lost profit recovery due to lack of a market price, see *supra* notes 91-105.

37. *Unique Sys., Inc.,* 622 F.2d at 379; *see also Leoni,* 255 N.W.2d at 826. In Pennsylvania, the seller must also prove that the contract-market formula of 2-708(1) is inadequate. *In re* Bacon's Estate, 18 Buck's Co. L.R. 39, 45 Pa. D. & C. 2d 733 (1968).

Under the Uniform Sales Act the seller was required to prove that he could not mitigate damages by using the capacity released by the breach. Goetz & Scott, *Measuring Sellers' Damages: The Lost-Profits Puzzle,* 31 STAN. L. REV. 323, 366 n.105 (1979).

38. *See Unique Sys., Inc.,* 622 F.2d at 378-79; *Leoni,* 255 N.W.2d at 826; Goetz & Scott, *supra* note 37, at 367.

39. *See* Bead Chain Mfg. Co. v. Saxton Prods., Inc., 183 Conn. at 278-79, 439 A.2d at 320; *infra* notes 40-41 and accompanying text.

liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed."[40] The U.C.C. rejects "any doctrine that damages must be calculable with mathematical accuracy"[41] and allows courts to liberally construe the language of the remedies sections. This policy of the U.C.C. is particularly important to sellers attempting to recover lost profits.

The rejection of the doctrine that damages be proven with mathematical certainty allows components sellers[42] and jobber sellers[43] to recover the lost profit damages they deserve. To prove lost profit damages a seller must prove, among other things, the cost of producing or acquiring the contract goods.[44] Proving production or acquisition costs, however, presents problems for components sellers and jobber sellers who, due to the buyer's breach, never produced[45] or acquired[46] the contract goods. These sellers can only predict what their production or acquisition costs would have been absent the breach. Few components sellers or jobber sellers would qualify for lost profit damages if they were required to prove projected costs with mathematical certainty.[47]

Lost volume sellers[48] would also be denied lost profit recovery were it not for the liberal administration of remedies provided for by the U.C.C.[49] Section 2-708(2) requires that the seller's recovery be reduced

40. U.C.C. § 1-106. This remedy theory is practically identical to general contract remedy theory. *See supra* note 1.

41. U.C.C. § 1-106 comment 1. The comment also states that "[c]ompensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more." *Id.* In Minnesota, lost profit damages must be proven with reasonable certainty. *See supra* note 35 and accompanying text.

42. A components seller assembles or manufactures goods for a buyer. *See infra* notes 75-113 and accompanying text.

43. A jobber seller buys goods from a manufacturer or another wholesaler and sells them at a higher price. *See infra* note 146 and accompanying text.

44. The gross profit produced by a sales contract is calculated by reducing the contract price by the direct cost of manufacturing or acquiring the contract goods. *See infra* notes 57-58 and accompanying text; *see also Baessetti,* 122 Minn. at 340, 142 N.W. at 324 (where goods are to be manufactured and the buyer breaches before completion, the measure of damages is the difference between the contract price and the cost to the seller of completing the contract).

45. *See infra* note 76 and accompanying text.

46. *See infra* note 148 and accompanying text.

47. Fortunately for components sellers and jobber sellers, once the fact of the loss is proven, difficulty in proving its amount will not bar recovery if the seller can present a reasonable basis upon which the loss may be approximated. *See Unique Sys., Inc.,* 622 F.2d at 378 (a new business can recover lost profits under Minnesota law if a reasonable basis exists upon which to figure the amount); *Leoni,* 255 N.W.2d at 826 ("Once the fact of loss has been shown, the difficulty of proving its amount will not preclude recovery so long as there is proof of a reasonable basis upon which to approximate the amount.").

48. A lost volume seller is a seller with a practically unlimited supply of goods which he uses to supply a limited number of buyers. *See infra* notes 114-15 and accompanying text.

49. *See infra* notes 50-51 and accompanying text.

by the proceeds received from resale of the contract goods.[50] Nevertheless, because the U.C.C. permits liberal construction of its remedies sections to provide just compensation,[51] courts are able to ignore the "due credit for proceeds of resale" clause when awarding lost profits to lost volume sellers.[52]

B. Calculation of Lost Profits

Under 2-708(2), the aggrieved seller may recover the "profit (including reasonable overhead) which [he] would have made from full performance together with . . . due allowance for costs reasonably incurred . . . ."[53] This recovery is reduced by any payments made by the buyer and any proceeds the seller receives from reselling the goods.[54] The valuation of the amount by which the award will be reduced poses few problems for courts calculating damages.[55] Most damage valuation problems involve the calculation of profits, reasonable overhead, and costs reasonably incurred.[56]

The most important element of the seller's recovery under 2-708(2) is lost profits. "Profits" is a general term which may refer to either gross profits or net profits. Gross profit is calculated by subtracting the cost of goods sold from sales revenue.[57] In sales contract terms, gross profits is the contract price reduced by the direct cost of producing or acquiring the contract goods.[58] Direct manufacturing costs, often referred to as variable costs,[59] include such expenses as material costs and direct labor costs. Net profits are determined by subtracting indirect costs, or over-

50. *See supra* note 29 (text of U.C.C. § 2-708(2)). Since the lost volume seller requires lost profit recovery to be placed in the same position as full performance by the buyer would have, reduction of the lost profit recovery by the proceeds of resale would eliminate 2-708(2) as an adequate remedy formula. *See infra* notes 122-25 and accompanying text.

51. *See* U.C.C. § 1-106.

52. Courts have relied primarily on 2-708(2)'s legislative history to support their liberal construction. *See infra* notes 137-39 and accompanying text.

53. U.C.C. § 2-708(2).

54. *Id.*

55. The dollar value of amounts received as payment or resale proceeds are easily ascertainable in most cases. If the seller is a lost volume seller, the resale proceeds are not deducted from the seller's damages. *See infra* notes 137-39 and accompanying text.

56. *See* J. WHITE & R. SUMMERS, *supra* note 2, § 7-13, at 284-88.

57. A seller's gross profits are measured by subtracting the cost of goods sold from the revenues received. P. WALGENBACH, N. DITTRICH & E. HANSON, FINANCIAL ACCOUNTING, AN INTRODUCTION 129 (2d ed. 1980) [hereinafter cited as WALGENBACH].

58. *See, e.g.,* Hodes v. Hoffman Int'l Corp., 280 F. Supp. 252, 257 (S.D.N.Y. 1968); Stuart Kitchens, Inc. v. Stevens, 248 Md. 71, 74, 234 A.2d 749, 751 (1967); Jericho Sash & Door Co. v. Building Erectors, Inc., 362 Mass. 871, 872, 286 N.E.2d 343, 344 (1972); Jessup & Moore Paper Co. v. Bryant Paper Co., 297 Pa. 483, 488-89, 147 A. 519, 522 (1929); Coast Trading Co. v. Parmac, Inc., 21 Wash. App. 896, 909-11, 587 P.2d 1071, 1079 (1978).

59. Direct and variable costs generally go directly to the production of goods and therefore vary with the level of production. These costs are "incurred in reliance on the

head, from gross profits.[60]

The Code does not specify whether "profits (including reasonable overhead)" under 2-708(2) means gross profit or net profit. All reported cases are in agreement, however, that "profits (including reasonable overhead)" is the equivalent of net profits plus overhead[61] or gross profits including overhead.[62]

Overhead is defined as "those relatively stable expenses which are essential to performance and which continue even if the performance of a specific contract is temporarily halted."[63] Examples of overhead expenses include property taxes and managerial and clerical salaries. These expenses are distinguished from variable expenses, such as material and labor costs, which are "incurred in reliance on the contract, which may be identified to a specific contract and which, if the contract is not performed, could be avoided."[64] Under 2-708(2) reasonable overhead is included in lost profit recovery.[65]

Common law courts were less willing to award overhead costs.[66]

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contract . . . identified to a specific contract and . . . if the contract [is] not performed, could be avoided." Neumiller Farms, Inc. v. Cornett, 368 So. 2d 272, 277 (Ala. 1979).

The terms direct cost and variable cost can be used interchangeably in most situations. In certain situations, however, variable costs may be indirect costs. For example, administrative salaries are usually considered to be indirect fixed costs because they are not identified to any specific goods and are not normally affected by the breach of a single sales contract. If the breached sales contract supplies a very large percentage of the company's business, the breach may result in a reduction in the company's administrative work force. In such a situation, administrative costs are considered variable in relation to the breached contract. *See* R & I Elec., Inc. v. Neuman, 66 A.D.2d 836, 838, 411 N.Y.S.2d 401, 404-05 (1978); DUNN, *supra* note 16, § 6.5.

60. WALGENBACH, *supra* note 49, at 129.

61. *See, e.g.,* Vitex Mfg. Corp. v. Caribtex Corp., 377 F.2d 795 (3d Cir. 1967); *Jessup & Moore,* 297 Pa. 483, 147 A. 519; *see also* DUNN, *supra* note 16, § 6.5.

62. *See, e.g., Unique Sys., Inc.,* 622 F.2d at 379 (applying Minnesota law); *Neumiller Farms, Inc.,* 368 So. 2d at 276-77; *Bead Chain Mfg. Co.,* 183 Conn. at 277, 439 A.2d at 320; *see also* DUNN, *supra* note 16, § 6.5.

63. *Neumiller Farms, Inc.,* 368 So. 2d at 277; *see also* G. SCHILLINGLAW, COST ACCOUNTING: ANALYSIS AND CONTROL 373 (rev. ed. 1967). Examples of overhead expenses are executive and clerical salaries, property taxes, and general and administrative expenses. *Vitex Mfg. Corp.,* 377 F.2d at 798.

64. *Neumiller Farms, Inc.,* 368 So. 2d at 277. According to the *Neumiller* court, variable costs are costs which are directly incurred to produce the contract goods. *Id.*

65. There is no authoritative application of the reasonability limitation on overhead recovery. One commentator suggests that the limitation is designed to allow the seller recovery for any items which can reasonably be classified as overhead, rather than to limit overhead recovery to a reasonable amount. R. NORDSTROM, LAW OF SALES § 177 (1970).

66. The courts were divided on how to treat overhead. Some held that overhead was a cost saved by the breach. These courts deducted overhead from the contract price when calculating lost profits. *See, e.g., Willhelm Lubrication Co.,* 197 Minn. at 632-34, 268 N.W. at 636-37; Worrell & Williams v. Kinnear Mfg. Co., 103 Va. 719, 723-24, 49 S.E. 988, 989-91 (1905). Other courts held that overhead is a fixed cost not saved by the breach. Overhead, therefore, was not deducted from the contract price and was recovered as gross profit. *See, e.g., Jessup & Moore,* 297 Pa. 483, 147 A. 519.

Under the common law, a seller attempting to recover overhead expenses had to prove that the time and capacity saved by not having to perform the contract was not used to generate new profits.[67] If the seller failed to meet this burden, the court reduced the award by the amount of fixed and overhead costs allocated to the released capacity. These cases have subsequently been criticized as improperly including overhead as a cost saved by the breach.[68]

Recovery under 2-708(2) includes overhead allocated to the breached contract because without such recovery a seller is not placed in the same position as full performance.[69] To recover overhead costs during a business year a seller must allocate them to the goods sold. When a contract is breached and the seller's sales volume is reduced, the seller has fewer goods to which overhead costs can be allocated. If the overhead costs allocated to the contract goods are not recovered as damages, those costs must be allocated to his remaining contracts. The profitability of those contracts is thereby reduced[70] and the seller is left in a position worse than if the contract had been performed.[71]

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67. Goetz & Scott, *supra* note 37, at 368.

68. *Id.*

69. Recovery of overhead is more of a problem for sellers recovering under 2-708(2) than for sellers recovering under other U.C.C. seller's remedies. If a seller recovers contract-market damages (2-708(1)), or contract-resale damages (2-706), or recovers the contract price (2-709), total costs incurred will be reimbursed. The seller is then not forced to reallocate the overhead to other goods. Speidel & Clay, *supra* note 1, at 711 & n.87.

Allocation of overhead to particular goods is necessary to recover these costs. Although allocation is often arbitrary and dependent on relative volume, accuracy may be increased by using predetermined overhead rates derived from cost averages during periods of normal production. Speidel & Clay, *supra* note 1, at 689 n.31; *see also* SCHILLINGLAW, *supra* note 63, at 82-83, 207-22, 687-89; *cf. Vitex Mfg. Corp.*, 377 F.2d at 799 (pro-rata allocation of overhead costs is an analytical construct not normally directly related to any individual transaction).

70. Since the profit produced by a sales contract is the difference between the contract price and total costs, any increase in total costs decreases the profit. *See* Speidel & Clay, *supra* note 1, at 692. The aggrieved seller is entitled to receive gains prevented by the breach. *See Vitex Mfg. Corp.*, 377 F.2d at 798.

71. Speidel & Clay, *supra* note 1, at 692; J. WHITE & R. SUMMERS, *supra* note 2, § 7-13, at 286.

Speidel and Clay argue that not all sellers should recover overhead costs. They divide a seller's activities into three production stages based upon the relationship between average variable costs per unit and average fixed costs per unit. A seller enters production stage III when average variable costs per unit begin to increase faster than average fixed costs per unit are decreasing. According to Speidel and Clay, stage III is the most rational operating stage for a seller attempting to recover his costs and earn a profit. Speidel & Clay, *supra* note 1, at 697.

Speidel and Clay's thesis is that, "if a seller is in stage III, the allowance of overhead as damages will put him in a better overall position than if the buyer had fully performed." *Id.* For a stage III seller, "the savings realized from not having to incur [increased] variable costs equal or exceed the loss from being unable to spread fixed costs over one more unit of production." *Id.* at 711.

Speidel and Clay admit that their interpretation of the reasonable overhead clause of

In addition to profit, the seller can recover the costs reasonably incurred towards performance of the contract.[72] These costs are the variable costs reasonably expended towards performance of the contract.[73] If costs could have been avoided through diligence and reasonable efforts, they will be deemed unreasonably incurred costs which the seller may not recover.[74]

IV. THE COMPONENTS SELLER

A components seller is a seller who agrees to assemble or manufacture contract goods for a buyer.[75] If the buyer breaches the contract before the goods are finished and the components seller reasonably elects not to complete production, courts and commentators generally agree that the seller is entitled to recover lost profits under 2-708(2).[76] This is a departure, however, from the common law and the Uniform Sales Act.

Common law courts generally awarded lost profits only to sellers of specially ordered goods.[77] If there was a ready market for the goods the seller was limited to recovery of the contract price-market price differential.[78] In addition, under the Uniform Sales Act it was required that the seller have access to a ready market.[79] A seller electing not to complete performance could recover lost profits under Uniform Sales Act section 64(4)[80] by showing that he could not make substitute contracts on the

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2-708(2) presents new problems of proof for the seller. *Id.* at 712. They also admit that their economic cost theory may increase the cost and difficulty of proving losses to the point of making their theory impractical in application. *Id.* at 713.

72. *See supra* note 29 (text of U.C.C. § 2-708(2)).

73. *See* Nobs Chem., U.S.A., Inc. v. Koppers Co., 616 F.2d 212, 216 (5th Cir. 1980).

74. *See Neumiller Farms, Inc.*, 368 So. 2d at 277. This is consistent with the mitigation of damages principle of general contract law. *See supra* note 2 and accompanying text.

75. J. WHITE & R. SUMMERS, *supra* note 2, § 7-10.

76. *See, e.g., Unique Sys., Inc.*, 622 F.2d 373; *Nobs Chem.*, 616 F.2d 213; *Neumiller Farms, Inc.*, 368 So. 2d 272; *Bead Chain Mfg. Co.*, 183 Conn. 266, 439 A.2d 314; Cesco Mfg. Corp. v. Norcross, Inc., 7 Mass. App. 837, 391 N.E.2d 270 (1979); Timber Access Indus. Co. v. U.S. Plywood-Champion Papers, Inc., 263 Or. 509, 503 P.2d 482 (1972); *Detroit Power Screwdriver*, 25 Mich. App. 478, 181 N.W.2d 828; Chicago Roller Skate Mfg. Co. v. Sokol Mfg. Co., 185 Neb. 515, 177 N.W.2d 25 (1970); J. WHITE & R. SUMMERS, *supra* note 2, § 7-13. *But see* Goetz & Scott, *supra* note 37; Peters, *Remedies For Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap For Article Two*, 73 YALE L.J. 199 (1963).

77. Goetz & Scott, *supra* note 37, at 328 n.15; *see, e.g.*, Schloss v. Josephs, 98 Minn. 442, 108 N.W. 474 (1906).

78. Goetz & Scott, *supra* note 37, at 323-24.

79. *Id.* at 324; *see Jessup & Moore*, 297 Pa. 483, 147 A. 519 (if a fixed market price exists, the measure of damages is the difference between that sum and the contract price or, if the goods were specially prepared for the buyer, the loss is the difference between the resale price and the contract price).

80. Uniform Sales Act § 64 is the seller's remedy section of the Uniform Sales Act for non-acceptance. Goetz & Scott, *supra* note 37, at 328 n.15.

open market.[81]

Legislative history indicates that 2-708(2) was intended to apply in cases where a components seller reasonably ceases manufacture after learning of the breach.[82] In its 1949 draft form, 2-708 did not indicate whether it was intended to supply a remedy for the components seller.[83] In the 1954 revision, language was added to the section, unaccompanied by official explanation, which was designed to incorporate an appropriate measurement for salvage cases:[84] "due allowance for costs reasonably incurred and *due credit for* payments or *proceeds of resale.*"[85] According to the drafters, this clause was added to clarify the right of the seller to realize junk value when it is manifestly useless to complete the operation of manufacture.[86] Section 2-708(2) is tailored to fit the components seller who has reasonably ceased manufacture and attempts to salvage the contract materials he has on hand.

The crucial question for lost profit recovery is whether the components seller's decision not to complete the goods was reasonable.[87] The seller "in the exercise of reasonable commercial judgment" and "for the purposes of avoiding loss and of effective realization" may under 2-704 either "complete the manufacture . . . or cease manufacture and resell [the goods] for scrap or salvage value . . . ."[88] Completion makes the goods available for resale under 2-706, the seller's primary remedy, or if resale is impracticable, allows the seller to bring an action under 2-709 for the contract price. Once the components seller completes the goods after the breach, his status as a components seller is no longer relevant to the determination of which remedies are available to him. He is then in the same position as any other seller who is left in possession of completed goods after the breach.

One commentator interprets 2-704 in language resembling the common law mitigation of damages doctrine.[89] According to Professor Har-

81. *See Jessup & Moore,* 297 Pa. at 490, 147 A. at 522; Goetz & Scott, *supra* note 37, at 328 n.15.

82. *Cesco Mfg. Corp.,* 7 Mass. App. Ct. at 843, 391 N.E.2d at 274; 1954 AMENDMENTS AND RECOMMENDATIONS OF THE ENLARGED EDITORIAL BOARD TO § 2-708 14 (1954); J. WHITE & R. SUMMERS, *supra* note 2, § 7-10. *See generally* Peters, *supra* note 76, at 273 (2-708(2) is one of the only provisions remotely applicable).

83. The 1949 draft of section 2-708 is identical to its present form except that it did not include the present section's final clause. Goetz & Scott, *supra* note 37, at 328 n.15. *See supra* note 29 for the complete text of 2-708(2).

84. Goetz & Scott, *supra* note 37, at 328 n.15.

85. U.C.C. § 2-708(2) (emphasis added).

86. Goetz & Scott, *supra* note 37, at 328 n.15 (citing UNIFORM COMMERCIAL CODE: AMENDMENTS APPROVED BY ACTION OF THE AMERICAN LAW INSTITUTE AND THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM LAWS 14 (1954)).

87. *See generally* 1 SQUILLANTE & FONSECA, THE LAW OF MODERN COMMERCIAL PRACTICES § 3:101, at 387 (rev. ed. 1980).

88. U.C.C. § 2-704(2).

89. Harris, *A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial*

ris, a seller's decision not to complete the goods should be deemed reasonable unless the seller knew or should have known that this decision would enhance his damages and a decision to complete would not unreasonably impair or harm his other interests.[90]

The most important criterion for determining whether the components seller's decision not to complete the goods was reasonable is the availability of a resale market for the goods. The absence of a resale market makes the measures in 2-706 and 2-708(1) inapplicable. The contract-resale measure in 2-706[91] cannot apply when the seller cannot resell the goods.[92] The absence of a resale market also precludes application of the contract-market formula of 2-708(1).[93] Moreover, in most situations, a commercially reasonable seller would not incur the expenses necessary to complete performance[94] only to bring an action for the full contract price under 2-709.[95] Therefore, if the seller fails to find an available market in which to mitigate his damages, he may recover lost profits under 2-708(2).

Cases which present the least difficulty to courts evaluating components sellers' damage claims are those involving specially manufactured

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Code Results Compared, 18 STAN. L. REV. 66, 72 (1965); *see also* RESTATEMENT OF CONTRACTS § 336 (1932). The *Restatement* provides that "[d]amages are not recoverable for harm that the plaintiff should have foreseen and could have avoided by reasonable effort without undue risk, expense, or humiliation." *Id.* § 336(1).

90. Harris, *supra* note 89, at 72. It is generally agreed that a seller has a duty to mitigate his damages. *See* Speidel & Clay, *supra* note 1, at 685.

91. *See supra* note 30 (quoting U.C.C. § 2-706(1)).

92. Section 2-706 provides that the seller may recover the difference between the resale price and the contract price, together with incidental damages but less expenses. U.C.C. § 2-706. If the seller cannot resell the contract goods following the breach, no resale price can be established. Absence of a resale price precludes application of the contract-resale damage formula.

93. Section 2-708(1) provides that "the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price. . . ." U.C.C. § 2-708(1). Without a market price this formula cannot be applied.

94. Under 2-704, "an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell [the goods] for scrap or salvage value." U.C.C. § 2-704. *See generally* J. WHITE & R. SUMMERS, *supra* note 2, § 7-14 (discussion of U.C.C. § 2-704).

95. *See supra* note 32 (text of U.C.C. § 2-709).

Normally the buyer should not be liable for expenses the seller incurs toward completion after being informed of the breach. In certain circumstances, however, the seller may make a commercially reasonable decision to complete the contract goods and then find that no market exists by the time the goods are completed. Because the seller's decision was reasonable at the time, the seller should recover the full contract price. However, "[i]t will take a persuasive lawyer to convince a court that it should not measure the 2-704 decision by hindsight when the plaintiff, having completed, finds himself unable to resell." J. WHITE & R. SUMMERS, *supra* note 2, § 7-5, at 263 (footnote omitted).

goods.[96] When the goods are specially manufactured, the absence of a resale market induces a salvage decision under 2-704(2).[97] Courts uniformly agree that 2-708(2) is the only appropriate measure of damages in this situation.[98] The breaching buyer is the only market for a seller of specially manufactured goods. As the Connecticut Supreme Court stated in *Bead Chain Manufacturing Co. v. Saxton Products, Inc.*,[99] "a seller of uncompleted components whose market is composed solely of the buyer in breach cannot adequately measure his damages in any other way."[100]

Lost profit recovery due to the lack of a market is not limited to those situations where the lack of a market is attributable to the uniqueness of the goods. For example, in *Unique Systems, Inc. v. Zotos International, Inc.*,[101] the seller contracted to develop and manufacture a commercial hairspray system for a buyer.[102] The buyer repudiated the contract before placing any orders.[103] The court found that there was no market price because the buyer's anticipatory breach prevented the seller from producing the system in marketable quantities.[104] The contract-market measure of damages was therefore inadequate and the seller was awarded lost profits.[105]

The mere existence of a market does not determine the applicability of 2-708(2) to a components seller. The market must be one which, if

96. Specially manufactured goods are goods produced to the buyer's specifications and for which there exists no market but the buyer in breach. *See, e.g., Neumiller Farms, Inc.*, 368 So. 2d at 275-76 (some market for chipping potatoes existed but seller had no obligation to give priority to selling those potatoes allocated to buyer's contract); *Bead Chain Mfg. Co.*, 183 Conn. at 278-79, 439 A.2d at 320 (specially manufactured electronic parts); Industrial Circuits Co. v. Terminal Communications, Inc., 26 N.C. App. 536, 537, 216 S.E.2d 919, 920 (1975) (printed circuit boards). *See generally* Childress & Burgess, *Seller's Remedies: The Primacy of U.C.C. § 2-708(2)*, 48 N.Y.U. L. REV. 833, 876-77 (1983); J. WHITE & R. SUMMERS, *supra* note 2, § 7-5.

97. Goetz & Scott, *supra* note 37, at 358. When no resale market for the goods exists, it is not commercially reasonable for the seller to complete manufacture. *See supra* notes 89-93 and accompanying text.

98. *See, e.g.*, Anchorage Centennial Dev. Co. v. Van Wormer & Rodrigues, Inc., 443 P.2d 596, 599 (Alaska 1968); *Bead Chain Mfg. Co.*, 183 Conn. at 278-79, 439 A.2d at 320; *Detroit Power Screwdriver*, 25 Mich. at 486-88, 181 N.W.2d at 832-33; *Chicago Roller Skate Mfg. Co.*, 185 Neb. at 517-18, 177 N.W.2d at 27.

99. 183 Conn. 266, 439 A.2d 314.

100. *Id.* at 278-79, 439 A.2d at 320; *see also Neumiller Farms, Inc.*, 368 So. 2d at 276; *Detroit Power Screwdriver Co.*, 25 Mich. at 480, 181 N.W.2d at 833 (formula basing damages on the difference between market price and contract price is without meaning in the context of a contract for a specialty item which has no market); J. WHITE & R. SUMMERS, *supra* note 2, § 7-10.

101. 622 F.2d 373.

102. *Id.* at 375.

103. *Id.* at 376.

104. *Id.* at 378 (applying MINN. STAT. § 336.2-708).

105. *Id.* at 379.

availed of, would substantially mitigate the seller's damages.[106] For example, in *Cesco Manufacturing Corp. v. Norcross, Inc.*,[107] the seller was left with an odd number of completed and partially completed goods after the breach.[108] The *Cesco* court concluded that the seller's line of business materially differed from that which would be involved in the sale of an odd quantity of goods.[109] The court held that despite the existence of a market for the goods, "if the price was insufficient to justify the costs of finding [the market], the plaintiff could not be expected to do so."[110]

Some commentators are less convinced than the courts that 2-708(2) applies to the components seller. One commentator believes that the components seller's lost profits are too speculative[111] and that the 2-708(2) formula lacks guidelines for situations where the seller would have lost money had the contract been fulfilled.[112] Two other commentators contend that, like the common law rule, an exception to the contract-market formula in 2-708(1) should be made only for the seller of specially ordered goods where there is no available market.[113]

V. The Lost Volume Seller

Another seller entitled to recovery of lost profits under 2-708(2) is the lost volume seller.[114] A lost volume seller is a seller with a practically unlimited supply of goods to supply a limited number of buyers. The lost volume seller expects to make a profit from the sale of goods to each available buyer. When a buyer breaches, the seller's resale of the contract goods to a buyer who would have bought goods anyway does not reduce the damages the seller suffers. But for the buyer's breach, the seller would have received a profit from both the breaching buyer and

106. *Timber Access Indus. Co.*, 263 Or. at 525, 503 P.2d at 490; *see also Cesco Mfg. Corp.*, 7 Mass. App. 837, 391 N.E.2d 270.

107. 7 Mass. App. 837, 391 N.E.2d 270.

108. *Id.* at 839, 391 N.E.2d at 272.

109. *Id.*; *see also Timber Access Indus. Co.*, 263 Or. 509, 503 P.2d 482. In *Timber Access Indus. Co.*, the Oregon Supreme Court recognized the existence of a market for the goods if the goods had been completed. The court awarded lost profit damages, stating that "if the price was insufficient to justify the plaintiff's costs of producing the [goods], plaintiff could not have been expected to produce and sell them, nor would plaintiff's damages have been mitigated by its so doing." *Id.* at 525, 503 P.2d at 490.

110. 7 Mass. App. at 843, 391 N.E.2d at 274-75.

111. Peters, *supra* note 76, at 274. Peters states that only one element of the lost profits equation, salvage value, will be based on statistics while the other two elements, cost of completion and expected profit, must of necessity be speculative. *Id.* at 274 n.202. Peters' argument conflicts with the general remedy theory of the U.C.C., which rejects "any doctrine that damages must be calculable with mathematical accuracy." U.C.C. § 1-106 comment 1.

112. Peters, *supra* note 76, at 274.

113. *See* Goetz & Scott, *supra* note 37, at 358.

114. Professor Harris originated the term "lost volume seller." *See* Harris, *supra* note 89, at 97-98.

the resale buyer.[115]

The lost volume principle is illustrated in the following example. An automobile dealer, *S*, agrees to sell a car to *B* for $10,000. *B* repudiates the contract and *S* sells the car to *C* one week later for $10,000. *B* claims that he owes *S* nothing because *S* received from *C* the full $10,000 purchase price for the car. But for the breach, however, *S* would have sold cars to both *B* and *C* and would have had the profit from two sales instead of one.

A seller must satisfy three criteria to be classified as a lost volume seller.[116] First, the seller must prove that the person who bought the resold goods would have been solicited by the seller to buy other similar goods

had there been no breach. To satisfy this criterion, the seller must prove that he would have solicited another buyer[117] and that the particular resale buyer would have been solicited.[118] Second, the seller must prove that the solicitation of the resale buyer would have been successful.[119] This criterion generally poses few problems for the seller if the resale was successful. Finally, the seller must prove his ability to have performed the contract if the breaching buyer had not breached.[120]

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115. In Snyder v. Herbert Greenbaum & Assocs., 38 Md. App. 144, 380 A.2d 618 (1977) the appellee-seller contracted to sell carpet to the appellant-buyer. After the buyer wrongfully cancelled the contract, the seller resold the carpet. According to the court:

> Appellee's original expectation, then, would have been to make a profit from the sale of carpet to appellants, and, even if appellants did not breach, to make a profit on the sale of additional carpet to the buyers who, because of appellants' breach, became the resale purchasers. As a result of appellants' breach, the appellee would have lost one of these expected sales, and thereby was damaged to the extent of the profit he lost on that sale.

Id. at 154, 380 A.2d at 624.

The inadequacy of the contract-market formula and the necessity of awarding lost profits in certain situations was recognized under the Uniform Sales Act, particularly in the case of automobile dealers. *See supra* note 6. The lost volume argument for lost profit recovery was well stated by a Canadian court in Mason & Risch Ltd. v. Christner, 47 Ont. L.R. 52 (1920):

> Where the article sold is a machine or a piano, there is no such thing as an open market ready to absorb all that is cast upon it, but only a limited number of purchasers exist . . . . When [a sales] contract is broken, it is no answer to say 'you can sell your piano at the same price, and so have suffered no damage.' If the contract had not been broken, a second piano would have been sold and the dealer would have had the profit on two sales instead of one.

Id. at 54.

116. Harris, *supra* note 89, at 82.

117. Unless the seller is a commercial seller, he probably would not have solicited another buyer. A commercial seller who planned to go out of business before the breach occurred, or who had reached the limits of its planned production, also probably would not have solicited another seller. *Id.*

118. If the resale buyer was solicited as a result of the breach, this criteria is not satisfied. *Id.*

119. *Id.*

120. *Id.; see also* Famous Knitwear Corp. v. Drug Fair, Inc., 493 F.2d 251, 254-55 (4th

The lost volume seller must look to the 2-708(2) measure of damages to be placed in the same position as the buyer's full performance would have placed him.[121] The lost volume seller will not, however, recover the profits he lost if 2-708(2) is literally applied. Section 2-708(2) provides that the breaching buyer must be given "due credit for . . . proceeds of resale."[122] This means that the value which the seller receives from resale of the contract goods must be deducted from the lost profits the seller is entitled to recover. As a practical matter, if the due credit clause is applied to the lost volume seller, the measure of damages is equivalent to those in 2-708(1) and 2-706, assuming the goods are sold at approximately their market price.[123] Strictly applied, 2-708(2) awards the lost volume seller his lost profits and the cost of acquiring or producing the goods[124] minus, under the "due credit" clause, the resale proceeds. The lost volume seller is then left with the difference, if any, between the profit he would have earned on the original contract and the profit received from the resale contract.[125]

The history of 2-708(2) indicates that this is not the result intended by the drafters. The first draft of 2-708(2)[126] did not include the due credit clause.[127] The section simply stated that if the contract-market measure

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Cir. 1974); *Snyder,* 38 Md. App. at 157, 380 A.2d at 626; Neri v. Retail Marine Corp., 30 N.Y.2d 393, 398-99, 334 N.Y.S.2d 165, 169-70, 285 N.E.2d 311, 314 (1972); J. WHITE & R. SUMMERS, *supra* note 2, at 285.

121. The aim of the U.C.C. remedies is to put the aggrieved party in as good a position as if the other party had fully performed. U.C.C. § 1-106(1). *See supra* notes 40-41 and accompanying text.

122. *See supra* note 29 (text of U.C.C. § 2-708(2)). The due credit clause leaves the lost volume seller in approximately the same position as would 2-706 and 2-708(2). *See infra* notes 123-25 and accompanying text.

123. *See Snyder,* 38 Md. App. at 155, 380 A.2d at 625.

124. Section 2-708(2) gives the seller "due allowance for costs reasonably incurred." Since the lost volume seller is dealing with goods completed at the time of the sale, his reasonably incurred costs are the acquisition or production costs.

125. Suppose the original contract price is $100, consisting of $80 worth of production costs (costs reasonably incurred) and a $20 profit. If the goods are resold for $95, the seller recovers his production costs plus a $15 profit. Strictly applied, 2-708(2) will award the seller his lost profit ($20) plus his costs reasonably incurred ($80), minus the resale proceeds ($95). The lost volume seller will therefore recover $5. If the buyer would have performed, the seller would have received $35 (the $20 profit from the breached sale plus the $15 profit from the resale).

126. The first draft of 2-708(2) was made in 1944. UNIFORM REVISED SALES ACT, PROPOSED FINAL DRAFT NO. 1 § 110, at 58 (1944).

127. Section 110 of the *Uniform Revised Sales Act* states:

> *Damages for Nonacceptance.* The measure of damages for nonacceptance is the difference between the unpaid contract price and the price current at the time and place for tender together with any incidental damages under Section 112 but less any expense saved in consequence of the buyer's breach, except that if the foregoing measure of damages is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit the seller would have made from full performance by the buyer.

UNIFORM REVISED SALES ACT, Proposed Final Draft No. 1 § 110, at 58 (1944).

is inadequate, the measure is "the profit the seller would have received from full performance by the buyer."[128] This section provided precisely the measure of damages necessary to adequately compensate the lost volume seller.

The drafters added official comments in 1949 which emphasized that lost profits are to be awarded when standard priced articles are involved.[129] Professors White and Summers contend that the relevant characteristic that qualifies the seller of standard priced goods for recovery of lost profits is not the "standard pricedness" of the goods.[130] Rather, it is that a fixed price seller will lose one sale when the buyer breaches, and, even if he resells the goods to a second buyer, "he will still not be made whole by difference-money because he will have lost one sale, one profit, over the course of the year."[131]

In 1954, the due credit clause was added to 2-708(2).[132] According to the drafters, this clause was added to "extend the rule clearly to the right of repudiation and to clarify the right of the seller to realize junk value when it is manifestly useless to complete the operation of manufacture."[133] This clause effectively eliminated 2-708(2), as literally construed, from being a proper measure of damages for the lost volume seller.[134] Courts and commentators generally agree, however, that 2-708(2) is the proper measure for a lost volume seller.[135] The problem then is determining how 2-708(2) should be construed to provide the lost volume seller a fitting remedy. Fortunately for the lost volume seller, the U.C.C. provides for liberal administration of remedies.[136]

The courts agree that the due credit clause of 2-708(2) should be ig-

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128. *Id.*

129. The lost profit clause is explained in comment 2 to section 2-708:

> The provision of this section permitting recovery of expected profit including overhead where the standard measure of damages is inadequate, together with the new requirement that price actions may be sustained only where resale is impractical, are designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods.

U.C.C. § 2-708 comment 2.

130. J. WHITE & R. SUMMERS, *supra* note 2, at 275.

131. *Id.*

132. U.C.C. § 2-708(2) (1954 draft).

133. UNIFORM COMMERCIAL CODE: AMENDMENTS APPROVED BY ACTION OF THE AMERICAN LAW INSTITUTE AND THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM LAWS 14 (1954).

134. *See supra* note 125.

135. *See Famous Knitwear Corp.,* 493 F.2d at 254; *Snyder,* 38 Md. App. at 154-55, 380 A.2d at 624-25; *Neri,* 30 N.Y.2d at 400, 334 N.Y.S.2d at 169, 285 N.E.2d at 314. *See generally* J. WHITE & R. SUMMERS, *supra* note 2, at § 7-9; Goetz & Scott, *supra* note 37; Schlosser, *Construing U.C.C. Section 2-708(2) to Apply to the Lost Volume Seller,* 24 CASE W. RES. 686 (1973). *But see* Shanker, *The Case for a Literal Reading of U.C.C. Section 2-708(2) (One Profit for the Reseller),* 24 CASE W. RES. 697 (1973).

136. *See supra* notes 40-41 and accompanying text.

nored in a lost volume situation.[137] These courts rely primarily on section 2-708(2)'s legislative history for support. The New York Court of Appeals, for example, has held that the due credit clause is inapplicable to the lost volume seller's retail sales contract, concluding from the drafter's comments that the clause applies only where the goods are resold as scrap.[138] The Maryland Court of Special Appeals, depending on the same comment as the New York court, concluded that the due credit provision is apparently "intended to affect the rights of a particular class of sellers, which class does not include the 'lost volume seller.' "[139]

Most commentators agree with the results reached by the courts.[140] Professors White, Summers, and Harris agree that the courts should simply ignore the due credit language in lost volume cases.[141] White and Summers state that "[g]ross errors of the kind here committed by the drafters call for extraordinary solutions."[142] Professor Schlosser offers an alternative method under 2-708(2). He contends that the phrase "profit . . . which the seller would have made from full performance" should be read to comprise the profit lost from the breach *and* the profit on the resale contract.[143] The lost volume seller may then give the breaching buyer due credit for the proceeds of resale and still retain the profit lost from the breach.[144] The principle that the proceeds of a resale contract

137. *Famous Knitwear Corp.*, 493 F.2d at 254; *Snyder*, 38 Md. App. at 155-56, 380 A.2d at 625-26; *Neri*, 30 N.Y.2d at 399, 334 N.Y.S.2d at 169, 285 N.E.2d at 314.

138. *Neri*, 30 N.Y.2d at 399 n.2, 334 N.Y.S.2d at 169 n.2, 285 N.E.2d at 314 n.2. The comment upon which the *Neri* court depended states that the "due credit clause is intended to refer to the privilege of the seller to realize junk value when it is manifestly useless to complete the operation of manufacture." *Id.* (quoting Supp. No. 1 to the 1952 Office Draft of Text and Comments of the Uniform Commercial Code, as amended by the action of the American Law Institute of the National Conference of Commissioners on Uniform Laws at 14 (1954)).

139. *Snyder*, 38 Md. App. at 154-55, 380 A.2d at 624-25. The *Snyder* court also depended upon its own statutory construction rule that " 'results that are unreasonable or inconsistent with common sense should be avoided, whenever possible.' Our holding avoids a result that is clearly 'inconsistent with common sense.' " *Id.* at 158, 380 A.2d at 626-27 (citing Height v. State, 225 Md. 251, 259, 170 A.2d 212, 215 (1960) and Maguire v. State, 192 Md. 615, 65 A.2d 299 (1949)).

In *Famous Knitwear Corp.*, 493 F.2d 251, the court stated that, were the due credit clause not omitted, the measure of damages would be substantially the same as the contract-market differential of § 2-708(1). The *Famous Knitwear Corp.* court concluded that 2-708(2) would thus have meaning only for the salvaging seller/manufacturer and not the seller of standard priced goods. The court held that the official comment to section 2-708(2) negated such purpose on the drafters' part. *Id.* at 254.

140. *See, e.g.*, Goetz & Scott, *supra* note 37; J. WHITE & R. SUMMERS, *supra* note 2, § 7-13, at 285. *But see* Shanker, *supra* note 135.

141. J. WHITE & R. SUMMERS, *supra* note 2, § 7-13, at 285; Harris, *supra* note 89, at 99.

142. J. WHITE & R. SUMMERS, *supra* note 2, § 7-13, at 285.

143. Schlosser, *supra* note 135, at 692-93.

144. *Id.* There are two significant problems with Schlosser's formula. First, the formula requires that the contract goods be traced to a particular contract so that the resale profit can be determined. This is impossible where the goods are fungible or where

are not always applied to reduce the breaching buyer's liability is followed by courts and commentators alike.[145] The general consensus is that 2-708(2) is an equitable and workable remedy for the lost volume seller.

VI. THE JOBBER SELLER

A jobber buys goods from a manufacturer or from another wholesaler and sells them at a higher price to a dealer.[146] The jobber depends on the purchase price-resale price differential to make a profit, pay his overhead costs, and recover his expenses.[147] To be placed in the same position as full performance, the jobber who did not acquire the contract goods before the breach needs to recover his lost profit, overhead, and expenses. This is precisely the remedy provided by 2-708(2).

A jobber may use the 2-708(2) measure of damages if he did not acquire the contract goods and his decision not to acquire the goods was based upon reasonable commercial judgment.[148] Using reasonable commercial judgment, the seller must decide whether he can reduce his losses by acquiring the goods, reselling them, and pursuing either the contract-resale remedy of section 2-706 or the contract-market remedy of section 2-708(1). Acquisition and resale of the goods may enable the seller to recoup some or all of his expenses and profit from a second buyer, thus reducing the original buyer's liability for the breach. If reasonable commercial judgment dictates that acquisition of the goods will increase the breaching buyer's liability, the seller should refrain from acquiring the

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particular goods have not been identified to the contract at the time of breach. Determination of resale profit will also be very difficult if the contract goods are resold as parts of many different contracts. Therefore, tracing the contract goods to a resale contract may substantially increase the seller's burden of proof.

Second, Schlosser's formula requires proof of a sales contract with a third party, the formation and performance of which is completely independent of the breached contract. It is purely coincidental that the breach turned one of the seller's contracts into a resale contract. A seller seeking lost profit damages should not be burdened with proving the existence of a contract so unrelated to the actual damage suffered.

145. *See supra* notes 137-44 and accompanying text.

146. In an economic sense, a jobber is an operative of the wholesaling process. His service in the process is to relieve the manufacturer of direct contact with the dealer. United States v. United States Gypsum Co., 67 F. Supp. 397, 481 (D.D.C. 1946).

147. *See* Irving Tier Co. v. Griffin, 244 Cal. App. 2d 852, 868-69, 53 Cal. Rptr. 469, 480 (1966).

148. *See, e.g.,* Blair Int'l, Ltd. v. LaBarge, Inc., 675 F.2d 954 (8th Cir. 1982); Nobs Chem., U.S.A., Inc. v. Koppers Co., 616 F.2d 212 (5th Cir. 1980); Timber Access Indus. Co. v. United States Plywood-Champion Papers, Inc., 263 Or. 509, 503 P.2d 482 (1972). Section 2-704 states that, if the contract goods are not finished (or in the jobbers case, not acquired) at the time of breach, the seller may, "in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete . . . (or acquire) the goods to the contract or cease manufacture (or performance)." U.C.C. § 2-704.

goods and may recover damages under 2-708(2).[149]

If the jobber acquires the contract goods, his status as a jobber is not a factor in determining which remedies are available. A jobber in possession of contract goods is in the same position as any seller in possession of finished goods after the buyer's breach. He has the option, under the appropriate circumstances, of pursuing any of the seller's remedies provided in the Code.[150]

According to the courts, 2-708(2) is the only remedy available to the jobber seller who properly refrains from acquiring the contract goods.[151] Because the seller does not have the goods, he cannot resell them. The contract-resale measure of 2-706, the seller's primary remedy, does not apply.[152] The seller's lack of possession of the contract goods also precludes an action for price under 2-709.[153] Moreover, the contract-market measure of 2-708(1) is inadequate where the seller has no goods with which he can recover the market price.[154]

Professors Goetz and Scott argue that the contract-market formula is the proper measure of damages for the jobber seller.[155] They define market price as wholesale price,[156] which is the jobber seller's cost of acquisition.[157] Under their formula, therefore, the jobber seller would recover

149. *See Nobs Chem.,* 616 F.2d at 215. A jobber must satisfy two conditions to recover under 2-708(2): "[f]irst, he [must be] a seller who never acquires the contract goods. Second, his decision not to acquire those goods after learning of the breach [must] not [be] commercially unreasonable." *Id.* (quoting J. WHITE & R. SUMMERS, *supra* note 2, § 7-10); *see also Blair Int'l, Ltd.,* 675 F.2d at 960.

150. *See* U.C.C. § 2-703 (general remedies for sellers). The jobber seller who acquired the contract goods may recover his lost profits if he is a lost volume seller. *See supra* notes 114-45.

151. *See, e.g., Blair Int'l, Ltd.,* 675 F.2d 954 (2-708(2) applied to a jobber seller who did not acquire goods because 2-708(1) measure was inadequate); *Nobs Chem.,* 616 F.2d 212 (2-708(2) applied to jobber seller who did not acquire contract goods because action for price under 2-709 and contract-resale measure of 2-706 were not available). *See generally* J. WHITE & R. SUMMERS, *supra* note 2, § 7-10.

152. *See Nobs Chem.,* 616 F.2d 212.

153. *See supra* note 14 (circumstances under which seller may bring an action for price).

154. Under 2-708(1) the seller is awarded the difference between the contract price and the market price of the goods. The seller without goods with which to recover the market price is not placed in the same place as full performance. *See Blair Int'l, Ltd.,* 675 F.2d 954.

155. Goetz & Scott, *supra* note 37, at 357 & n.81.

156. *Id.* The conventional interpretation of market price in 2-708(1) is the price the seller could receive by selling the contract goods to a buyer in an available market. *See Timber Access Indus. Co.,* 503 P.2d at 490.

157. *See supra* note 146 and accompanying text. This interpretation is contrary to the language of 2-708(1), which provides that the market price be established "at the time and place for tender." The goods are tendered when the seller holds conforming goods at the buyer's disposition and gives the seller any reasonable notice necessary to enable him to take delivery. U.C.C. § 2-503(1). The conventional interpretation of "market price at the time and place for tender" is the price the seller could receive by selling the contract goods to a buyer in an available market. *See, e.g., Timber Access Indus. Co.,* 503 P.2d at 490.

the difference between the contract price and the acquisition price of the goods.

Goetz and Scott admit that their formula is "merely a mechanism for recovering the seller's actual profits."[158] They claim, however, that the award of actual lost profits under their formula is preferable to the expected lost profit award under 2-708(2).[159] Goetz and Scott contend that proof of the contract and wholesale prices under their formula is less costly than the direct proof of lost profits required under 2-708(2).[160] The courts have not adopted Goetz and Scott's hypothesis.[161] There is little incentive for the courts to adopt such a liberal interpretation of 2-708(1) when the jobber seller is adequately compensated under 2-708(2).

VII. CONCLUSION

Lost profit recovery is an essential part of a seller's recovery for breach of contract. Because virtually all sellers enter a contract expecting to earn profits, the aggrieved seller's damage recovery must include lost profits to place him in the same position as full performance would have done. Despite its poor drafting, courts have consistently interpreted U.C.C. section 2-708(2) to allow lost profit recovery by deserving sellers. The section expressly recognizes that lost profits, despite their speculative nature, are a proper measure of damages for breach of contract. Section 2-708(2) thus allows courts to award lost profits to sellers not adequately compensated by other remedies, and is an essential component of the seller's remedies provided by the Code.

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158. Goetz & Scott, *supra* note 37, at 357 n.81.

159. *Id.* According to Goetz and Scott, the jobber seller's actual lost profit is the contract price less the wholesale market price. *Id.* The normal measure of profits under 2-708 is the difference between the contract price and production or acquisition costs. *See supra* note 58 and accompanying text. Since the jobber seller did not acquire the goods he can only prove his expected profit.

160. Goetz and Scott, *supra* note 37, at 357 n.81.

161. Courts which have addressed the issue unanimously agree that 2-708(2) is the proper remedy formula for the jobber seller who properly refrains from acquiring the contract goods. *See supra* notes 151-54 and accompanying text.